# *State of New York*
# *Office of the State Comptroller*
# *Division of Management Audit*

## STATE EDUCATION DEPARTMENT

## MONITORING AND REPORTING THE FISCAL STATUS OF DEPARTMENT OPERATIONS

**REPORT 96-S-31**


***H. Carl McCall***

*Comptroller*

# State of New York
# Office of the State Comptroller

**Division of Management Audit**

**Report 96-S-31**

Mr. Carl T. Hayden
Chancellor
The University of the State of New York
State Education Building
Albany, NY 12234

Dear Mr. Hayden:

The following is our report on the practices used by the State Education Department to monitor and report on the fiscal status of Department operations.

This audit was done according to the State Comptroller's authority as set forth in Section 1, Article V of the State Constitution and Section 8, Article 2 of the State Finance Law and at the request of the Commissioner of the State Education Department. We list major contributors to this report in Appendix A.

*Office of the State Comptroller*
*Division of Management Audit*

**October 4, 1996**

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# Executive Summary

# State Education Department Monitoring And Reporting The Fiscal Status Of Department Operations

## Background, Scope and Objectives

The State Education Department (Department) was appropriated about $262 million for the 1995-96 fiscal year (excluding capital funds and appropriations for aid to school districts). The Department's Administration program is funded by a State appropriation and charges against Federal programs and Special Revenue operations. The resulting revenue is accumulated in the Department's Cost Recovery account. For fiscal year 1995-96, the Administrative program was to receive about $32 million in State, cost recovery and grant funds. Funds for Federal programs are available to the Department to the extent that staff effort is used to administer such programs. Many employees do not work exclusively on one program. Thus, management developed the Time and Effort Allocation System (TEAS) to accumulate staff time according to programs. The Department uses the TEAS data to claim Federal reimbursement for the State.

In March 1996, financial managers reported that the Department's cumulative operations deficit would total $11.46 million as of March 31, 1996, if no corrective action was taken. About $5 million of the deficit occurred prior to the 1995-96 fiscal year. The current Commissioner of Education, Richard Mills, took office in September 1995. The fiscal problems discussed in this report originated under the prior administration. In March 1996, the Commissioner requested the State Comptroller to undertake an audit of the Department's financial systems.

The objective of our audit was to answer the following questions:

- What was the Department's operating deficit as of March 31, 1996?
- What improvements are needed in the Department's financial systems to provide better fiscal accountability and help prevent deficits from recurring?
- What technology changes could be made to improve the financial systems used by the Department.

## Audit Observations and Conclusions

In March 1996, Department managers prepared a *Summary of Financial Position* (schedule) which listed the components of a projected $11.46 million deficit and the planned actions to reduce the deficit to $5.3 million by the end of fiscal year 1995-96. The actual deficit resulting from these items was about $3.7 million. The deficit was lower than projected because the Division of the Budget relieved the Department of responsibility for certain employee separation costs and because the Department increased its Federal reimbursement above the levels it previously projected. The amount we calculated also included accrued obligations of $516,000 and additional employee separation

costs of $109,000 that were not included in the Department's calculation. (See pp. 5-8)

We found that management had not established adequate financial reporting systems and controls. The Department's financial systems have not provided accurate and timely information to upper management. Furthermore, controls over the use of journal vouchers and the TEAS do not provide adequate assurance that all transactions are appropriate. As a result, management did not have adequate knowledge of the Department's financial status and, therefore, could not effectively deal with the deficit on a timely basis. (See pp. 9-11)

Through our review of TEAS, we identified several control weaknesses related to Program Activity Assignment Sheet (PAAS) completion and time sheet certification. We noted, for example, substantial increases in reported effort for certain Federal programs during the fourth quarter of the 1994-95 TEAS year. Department managers informed us that about 140 employees were transferred from one program to another during the year. However, PAAS forms were completed for 79 of these employees after the close of the year. These PAAS forms changed their time allocation between Federal programs retroactively, generally back to January 1995. As permitted by Federal guidelines, these forms were completed between July and October 1995. (See pp. 13-15)

Controls over the use of journal vouchers were not adequate. There were 39 staff who were authorized to approve journal vouchers. About half of these individuals were clerical staff. However, there were no limitations on the size of the transactions which could be approved. Also, there were no periodic reports to management summarizing the number and value of journal vouchers. In several cases, staff informed us that there was no documentation to support amounts included on the journal vouchers. For example, journal voucher #921 (processed on March 28, 1996) transferred $842,000 of costs from a Federal program to various State accounts. However, there was no documentation to support this transaction. (See pp. 16-18)

The Department's deficit schedule did not include the cost of all obligations incurred in fiscal year 1995-96 which were not yet paid. These obligations totaled about $516,000. One of the reasons these obligations had not been considered is that Department managers did not have a system for identifying these obligations. (See p. 18)

Also, the Department needs to expand the use of technology to: reconcile the TEAS with other accounting records; improve the accuracy and timeliness of data for the Cost Recovery account; and summarize employee separation costs. (See pp. 21-26)

## Comments of Department Officials

Department officials agreed with our report's recommendations. Officials also advised us of the actions they have taken and plan to take to implement our recommendations.

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# Introduction

## Background

The State Education Department (Department) is charged with the general management and supervision of all public schools and all of the educational work of the State. The State Legislature appropriated about $262 million to the Department for State operations for the 1995-96 fiscal year. (Note: This amount excludes appropriations for capital improvements and aid to school districts.) The appropriations for major Department programs are summarized as follows:

| | ***(Amounts in millions)*** |
|---|---|
| Administration | $ 31.8 |
| Elementary, Middle, Secondary and Continuing Education (EMSC) | 81.8 |
| Office of the Professions | 29.6 |
| Higher Education | 13.1 |
| Vocational and Education Services for Individuals with Educational Disabilities (VESID) | 75.4 |
| Cultural Education | 30.0 |
| **Total** | $261.7 |

Appropriations for Department programs generally include a combination of State, Federal, and Special revenue funds. The following table summarizes the Department's funding (excluding administration) according to source:

| | *(Amounts in millions)* | | |
|---|---|---|---|
| **Program** | **State** | **Federal** | **Special Revenue** |
| EMSC | $16.2 | $ 63.3 | $ 2.3 |
| Professions | | | 29.6 |
| Higher Education | 2.1 | 7.1 | 3.9 |
| VESID | .6 | 73.8 | 1.1 |
| Cultural Education | 14.2 | 5.4 | 10.3 |
| **Totals** | $33.1 | $149.6 | $47.2 |

The Department's Administration program is funded by a State appropriation and charges against Federal programs and Special Revenue operations for their share of Department overhead costs. These charges are a fixed percentage of the total personal service costs for Federal programs and Special Revenue operations. These funds are accumulated in the Department's Cost Recovery account and are used to partially fund Administrative costs. For fiscal year 1995-96, the Administrative program was budgeted to receive $13.7 million in State funds, $17.6 million in cost recovery funds and $500,000 in grants from private sources.

Funds for administering Federal programs are available to the Department to the extent that staff effort is used to administer such programs. Employees are assigned to payroll lines that are either Federally or State funded. However, not all employees work exclusively on State or Federal programs. Further, the State payroll system cannot allocate employee time to more than three activities. Therefore, Department managers have developed a Time and Effort Allocation System (TEAS) to accumulate staff time expended on administering Federal programs. Information from this system is the basis for obtaining Federal reimbursement.

The current Commissioner of Education took office in September 1995. In November, 1995, Department managers projected that the Administration Cost Recovery account would end fiscal year 1995-96 with a deficit of $4.08 million. In March 1996, Department managers reported that the deficit for the Department would total $11.46 million for the fiscal year, if no corrective action was taken. Department records show that $5.04 million of the deficit occurred prior to April 1, 1995, while the remaining $6.42 million occurred during the 1995-96 fiscal year. In March 1996, Commissioner Richard Mills

requested the State Comptroller to audit the Department's financial systems because of the size and fluctuations in the projected deficit.

## Audit Scope Objectives and Methodology

At the request of the Commissioner of Education, we reviewed the Department's fiscal position and financial systems for the period April 1, 1995 through June 15, 1996. We also reviewed the types of technology incorporated in the Department's automated systems and plans for improvements. The primary objectives of our financial audit were to (1) determine the Department's operating deficit as of March 31, 1996, (2) evaluate the improvements needed in the Department's financial systems to provide better fiscal accountability and help prevent deficits from recurring and (3) determine what technology changes could be made to improve the financial systems used by the Department. To accomplish these objectives, we reviewed the Department's financial transactions and accounting records and interviewed appropriate Department and Division of the Budget staff. We limited our audit to the Department's operating funds and did not review the Department's administration of local assistance and capital funds.

We conducted our audit according to generally accepted government auditing standards. Such standards require that we plan and do our audit to adequately assess those Department procedures and operations included within the audit scope. Further, these standards require that we understand the Department's internal control structure and compliance with those laws, rules and regulations that are relevant to the Department's procedures and operations which are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach when selecting activities to be audited. This approach focuses our audit efforts on those procedures and operations that we have identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we used our finite audit resources to identify where and how improvements can be made. Thus, we devote little audit effort to reviewing procedures and operations that may be relatively efficient or effective. As a result, our reports are prepared on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

## Internal Control and Compliance Summary

Our consideration of the Department's internal control structure focused on administrative controls, which are defined as the procedures that effect the decision making processes leading to management's authorization of transactions. For this audit, these controls pertained to the monitoring and reporting of financial status, preparation of time distribution reports, determination of accounts payable, and accumulation of employee separation costs. Our audit identified some significant weaknesses in these areas, which are described in subsequent sections of this report.

## Response of Department Officials

We provided Department officials with draft copies of this report for their review and formal comment. We have considered officials' comments in preparing this report and have included them as Appendix B.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of Education shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

# Financial Status of Department Operations

Department managers prepared a *Summary of Financial Position* (schedule) on March 22, 1996 that summarized the components of the Department's cumulative operations deficit of $11.46 million (see Exhibit B). This schedule showed that several unrelated problems contributed to the deficit. The schedule also projected that planned deficit reduction actions would reduce the deficit to $5.3 million (see Exhibit B) by March 31, 1996.

However, based on the results of our review, we determined that the Department's actual cumulative deficit, as of March 31, 1996, was about $3.7 million (see Exhibit A). The deficit was lower than projected because the State Division of the Budget (DOB) relieved the Department of fiscal responsibility for certain employee separation costs and because the Department increased its Federal reimbursement above the levels it previously projected. We also added accrued obligations of $516,000 and employee separation costs of $109,000, that were not previously identified by the Department, to our calculation of the deficit.

The following subsections of this report provide explanations of the deficit components that are included in Exhibit B.

## Prior Fiscal Years' Deficits

The Department's schedule showed that $5.04 million of the deficit occurred prior to April 1, 1995 and was rolled forward into fiscal year 1995-96. Part of this $5.04 million deficit occurred because the Department could not charge Federal programs for $2.8 million in personal service costs for the EMSC program. Department managers told us that the Department reorganization in fiscal year 1992-93 caused changes in the job duties (activities) of a significant number of EMSC staff. Consequently, certain EMSC staff activities no longer qualified for the specific Federal programs that management had used to fund them. Although large portions of these EMSC activities (and the related costs) would have been allowable under other Federal programs, the total costs of these activities exceeded the available levels of funding. Therefore, since 1993, reimbursable Federal program efforts (and related costs) have been less than previously expected. About $2.8 million in planned Federal reimbursement was not realized over this period, and management used State appropriations to compensate for this revenue shortfall.

This deficit was subsequently rolled forward in successive fiscal years by journal vouchering charges between Federal and State programs. Department managers told us that they planned to begin reducing this deficit during the

1995-96 year. However, significant State budget reductions in that year precluded management from taking the planned corrective action.

Department managers attributed an additional $350,000 of the deficit to lower than expected Federal revenue reimbursement for the Higher Education program. They further informed us that this deficit was estimated, and no documentation was available to support the estimate. Managers also told us that they took actions to correct this deficit. These actions included:

- obtaining an increase in a Federal grant of $236,000;
- obtaining DOB approval to use previously unallocated funds; and
- increasing Federal reimbursement by correcting and resubmitting TEAS forms.

Our review of the available documentation of these actions showed that they would have sufficiently dealt with a deficit of $350,000. Consequently, this item no longer contributed to the cumulative deficit.

The final component of the cumulative deficit is a deficiency in the Administrative Cost Recovery account, which the Department reports to be $1.89 million. Department managers told us that there was a negative balance in the Cost Recovery account of $4.8 million at the beginning of fiscal year 1995-96. This amount represented prior years' deficits of various origins that had not been specifically identified. Management told us that DOB relieved the Department of responsibility for $2.9 million (of the $4.8 million) in costs charged to the Cost Recovery account. The net result of this relief was a deficit of $1.89 million in Cost Recovery account from prior fiscal years. We verified that there was a $4.8 million deficit in the Cost Recovery account at the start of the 1995-96 fiscal year. We also spoke to DOB officials and verified that relief of $2.9 million was granted to the Department.

## 1995-96 Fiscal Year Deficit

The Department's schedule showed that $6.42 million of the expected deficit would result from fiscal year 1995-96 operations (see Exhibit B). About $1.9 million of that amount resulted from the unexpected (and therefore unbudgeted) costs of staff reductions. The Department's budget for fiscal 1995-96 provided funding for about 300 fewer staff positions than the prior year. This budget reduction required managers to reduce staffing levels through early retirements, layoffs and reassignments to Federal or Special Revenue funded positions.

However, due at least partially to the late passage of the State budget, Department managers were not able to accomplish this staff reduction until well after the 1995-96 fiscal year began. Since the State budget was not

passed on time, Department managers could not know how many positions to reduce, if any, at the start of the fiscal year. As a result, the Department incurred payroll and separation costs (lump-sump and lag payroll payments) for positions that were not funded in the Department's budget. Department managers estimated that these unbudgeted costs added about $1.9 million to the deficit. However, we determined that separation costs were actually $109,000 more than the Department estimated (see Exhibit A).

The Department's schedule also reported that the remaining $4.51 million of the expected deficit consisted of:

- Cost Recovery account expenses that were expected to exceed revenues by $4.08 million;

- an expected deficit of $180,000 in the Higher Education program due to problems with Federal reimbursement; and

- an expected deficit of $250,000 in the Cultural Education program also due to problems with Federal reimbursement.

Department managers took actions to reduce the expected $4.08 million deficit in the Cost Recovery account. These mainly consisted of charges to Federal programs for cost recoveries that had not been made in prior fiscal years. In addition, revenue collections for overhead charges were more than previously projected. Therefore, Cost Recovery account transactions for fiscal year 1995-96 resulted in a net revenue surplus of about $2.09 million. Because Department managers previously projected a $4.08 million deficit, the net effect of the additional Cost Recovery account transactions was to reduce the cumulative estimated deficit by $6.17 million (see Exhibit A).

According to Department managers, the deficit of $180,000 for the Higher Education Program in 1995-96 was attributable to problems with Federal reimbursement. Management projected that actual effort was going to be less than anticipated and State funds would have to be used to pay for these expenses. Department managers subsequently analyzed this account and determined that the imbalance was occurring due to errors in employee TEAS forms, which staff subsequently corrected. We reviewed the Department's actions and verified that this $180,000 deficit was eliminated.

Managers also informed us that the projected $250,000 deficit in the Cultural Education program has been eliminated. This deficit resulted because management had to use State funds for Cultural Education programs that management expected to be Federally funded. When Federal funds became available, journal vouchers were processed to move these expenses to the appropriate Federal account. We reviewed these transactions and verified that the $250,000 deficit amount was eliminated.

## Unpaid 1995-96 Obligations

The Department identified deficit did not include unpaid General Fund obligations of at least $516,000 from fiscal year 1995-96 (see Exhibit A). These obligations represent goods and services that were received during fiscal year 1995-96, but the Department had not yet paid. As noted later in this report, the lack of adequate financial systems precluded us from establishing the exact amount of outstanding obligations.

According to Department officials, the Department will pay about $429,000 (of the $516,000) in obligations subsequent to March 31, 1996, when fiscal 1996-97 funds become available. In addition, over $87,000 in expenses for paper were temporarily charged to Federal programs. Management informed us that these charges will be reversed when State funds are available.

# Fiscal Management Concerns

Financial systems and controls are necessary to ensure that all transactions are correctly reported and that appropriate information is reported to management. Department managers are responsible for using resources efficiently, economically and effectively. They are also responsible for establishing and maintaining effective controls to ensure that appropriate goals and objectives are met; resources are safeguarded; laws and regulations are followed; and reliable data are obtained. To fulfill its responsibilities, management needs timely, complete and accurate information.

We determined that Department management had not established adequate controls over its financial management reporting systems. The Department's financial systems have not provided accurate and timely information to upper management. Controls over the use of journal vouchers and the TEAS do not provide adequate assurance that all transactions are appropriate. As a result, prior and current management did not have adequate knowledge of financial issues and could not effectively deal with the deficit on a timely basis.

## Lack of Management Action

Most of the cumulative $11.5 million deficit occurred prior to the 1995-96 fiscal year. According to Department officials, the $2.8 million deficit in Federal funding for the EMSC program began during the 1992-93 fiscal year when staff were reorganized into field teams. This reorganization reduced the level of available Federal funding to the Department. As a result, management had to use State funds for expenses for which Federal funding was no longer available. Rather than address this deficit effectively when it occurred, management simply rolled it forward into the following years. Thus, management did not take effective actions to correct the Department's underlying fiscal problems when they began to develop and became evident.

Likewise, the Cost Recovery account began the 1995-96 fiscal year with a cumulative deficit balance. Since State Law allows the Department to have a negative balance in this account, deficits can exist for extended periods of time. Deficits were allowed to accumulate over the years until current Department management began to take action by reducing expenditures and staff.

## Fiscal Management Reporting

Prior management's failure to address deficits in a timely manner may have also resulted from the lack of an adequate financial reporting system. Without regular financial reporting, management does not have the information it needs to monitor operations and take corrective actions. Moreover, the Commissioner and Board of Regents did not receive periodic financial reports while the majority of this deficit was occurring. Only since late 1995 has management required such information to be prepared. Only when such financial summaries were prepared was the full extent of the Department's deficit known to upper management.

Although current management has initiated certain improvements, the Department's fiscal reporting systems must be further strengthened. We found that these systems often relied too much on manual rather than automated processes. Consequently, senior management often did not have timely and/or accurate summary fiscal reports. Staff manually developed much of the data used to project the deficit by gathering data from reports and preparing hand-written spreadsheets or re-entering data for computerized summaries. For example, to determine the amount of employee separation costs incurred in fiscal 1995-96, staff had to manually review bi-weekly payroll registers, identify lump-sum payments by employee, and accumulate the payments manually. This process was repeated four times as separations took place during the 1995-96 year.

Staff prepare an estimate of receipts for the Cost Recovery account to help management to determine whether such receipts will be sufficient to pay costs that are charged to that account each year. In order to estimate these receipts, staff review a payroll summary report for one bi-weekly period and manually retrieve total payroll expenses for each Federal program and Special Revenue fund. Total payroll charges are then multiplied by overhead rates to calculate the estimated receipts. Staff must repeat a similar process quarterly to calculate the actual revenue to be collected by the Cost Recovery account. However, the manual nature of this review precludes staff from estimating Cost Recovery revenues on a more frequent basis and providing the estimates to management on a timely basis. Until November 1995, when it was requested by Commissioner Mills, management did not require a monthly status report for the Cost Recovery account to be prepared.

In 1992, a Department Internal Audit report also identified problems with the Department's financial reporting systems. That report indicated that the Department's financial systems do not provide program managers with timely or accurate information to monitor fiscal performance. Specifically, the report indicated that program managers did not always have reports of the amounts of funds allocated for their programs and accurate program expenditure data. However, former Department managers did not make the necessary improvements to the financial systems. As indicated in subsequent sections

of this report, current senior management was taking action to strengthen the Department's financial systems at the time of our review.

In responding to our draft report, Department officials stated that they have implemented a fiscal monitoring and reporting system that the Chief Financial Officer and the Budget coordination Bureau use to continuously monitor the Department's financial condition. This system includes monthly revenue and expenditure reports, which are provided to the Board of Regents and senior management. Officials also stated that they intend to further automate the system by linking it to the existing personnel and fiscal management systems when funding becomes available.

## Recommendations

1. Continuously monitor financial condition and address deficits as they occur.

2. Continue to update management reporting systems to ensure that relevant financial data is provided to managers timely.

3. Ensure that major accounts, such as the Cost Recovery account, are properly automated so that managers can monitor activity on an ongoing basis.

# Fiscal System Processes

We identified weaknesses in several aspects of the Department's fiscal management operations which hindered senior management's ability to effectively manage the Department's budgets and funding allocations. Specifically, we found that the Department needs to strengthen procedures relating to:

- management of the Time and Effort Allocation System (TEAS);
- TEAS deficit reduction activities;
- preparation and approval of journal vouchers; and
- identifying and summarizing unpaid obligations (accounts payable).

## Time and Effort Allocation System (TEAS)

The Department administers a number of Federally-funded programs and grants, each of which supports specific and discrete activities. Generally, Federal funds may only be used in support of activities allowable under the applicable Federal programs or grants. The Department is responsible for assuring that all Federal allocations are used appropriately. The Department maintains TEAS to account for the amount of effort staff spend on Federal and other programs and grants. Since most Federal program years run from July 1 through June 30 of the following year, each TEAS reporting year ends on the payroll period ending closest to June 30 and the next year begins with the following payroll period.

To receive Federal funding, all employees, doing any activities on behalf of Federal programs or grants, must have their efforts identified with activities on TEAS. Employees' effort may be assigned directly to one or more activities on TEAS or be allocated on the basis of an allocation plan. At the start of each TEAS year, all employees whose efforts will be assigned directly to one or more activities or allocated as support staff activities must certify their planned effort on a Program Activity Assignment Sheet (PAAS). An employee's PAAS form must also be certified by his or her supervisor.

During the year, the Department updates TEAS with payroll expenditure information from the State payroll system. TEAS allocates each employee's effort, in terms of payroll costs, to those activities identified on their PAAS form or according to an allocation plan. TEAS generates reports after every other payroll period for Department monitoring of Federal program efforts and expenditures. Because funding sources and employee efforts do not match exactly, the Department must reconcile actual fund charges with the actual Federal efforts reported. Department staff do reconciliations

throughout the year, usually quarterly, and a final reconciliation after the TEAS year ends.

A key control element in TEAS is the initial certification by employees and their supervisors of planned program activity on the PAAS form. Another is the ongoing certification on the time sheet that the employee is working according to the PAAS form time allocation. The employee's and supervisor's signatures on these forms represent the certifications. PAAS forms are to be completed and signed by the employee and supervisor at the start of the TEAS year. If an employee's assignment changes during the year, a new PAAS form should be completed at that time to reflect any change in their time allocation.

During our review of TEAS, we identified several control weaknesses related to PAAS form completion and time sheet certification. These control weaknesses could allow potential errors or misstatements of program efforts to occur. We noted, for example, substantial increases in reported effort for certain programs in VESID during the fourth quarter of the 1994-95 TEAS year. Department managers informed us that they transferred a number of employees to VESID from EMSC during the year which resulted in the large increase. We identified about 140 employees who were transferred to VESID based on revised PAAS forms.

We noted, however, that PAAS forms were completed for 79 of these employees after the close of the 1994-95 TEAS year. These PAAS forms changed the time allocations (for the 79 employees in question) among Federal programs retroactively, generally back to January 1995. These forms were completed in July through October 1995. Two of these employees completed retroactive PAAS forms after the TEAS year-end and then completed a second retroactive PAAS form, with different time allocations from the first. Also, one employee had left the Department when a retroactive PAAS form, signed only by the supervisor, was submitted to change his time allocation.

We further noted that four employees' time allocations changed on TEAS before the completion of their retroactive PAAS forms. The PAAS forms were signed by the supervisors in September 1995, however, a TEAS report dated July 27, 1995 already reflected the time allocations these forms were meant to establish. We found no prior PAAS forms which contained these time allocations for the four employees.

Department time sheets provide space for the employee's supervisor to note whether a PAAS form is required for the employee. If a PAAS form is required, the supervisor is to record the effective date of the PAAS form on the time sheet. Department procedures call for the supervisor to record this information after the employee has already signed the time sheet. In following

these procedures, an employee will likely not see the PAAS information and their signature certifying this information is meaningless.

For the 79 employees whose time allocations were changed retroactively, many of their time sheets submitted during the 1994-95 TEAS year contained the effective dates prescribed on PAAS forms filed during that year. Thus, these employees and their supervisors continued, throughout the year, to certify that the employees were carrying out the responsibilities prescribed on the earlier PAAS forms. Also, for the employees whose time sheets did not have a prior PAAS form date, the employee and supervisor either certified that no PAAS form was required or did not indicate whether a PAAS form was or was not required. For these employees, we reviewed TEAS data for one payroll period and found that TEAS allocated the employees' efforts according to the most current PAAS form data on file anyhow. Thus, for the purposes of the TEAS, the certifications of these employees' time sheets did not serve as a control. Retroactively changing the employee's time allocations after the year end made the initial certifications meaningless. Moreover, we believe that it raises questions about which activities the employees were actually carrying out. (Note: Guidelines prescribed by the U. S. Department of Education allow the Department to make retroactive changes to the TEAS for up to five months after the end of the TEAS year in question. Although we are concerned with certain aspects of the retroactive changes in question, those changes were made within the prescribed time limit.)

## TEAS Deficit Reduction Activities

The Office of Elementary, Middle, Secondary, and Continuing Education (EMSC) had a $2.8 million deficit at the start of the 1995-96 State fiscal year that was actually incurred in prior fiscal years and rolled forward to 1995-96. The deficit resulted from the inability to charge Federal programs for certain EMSC personal service costs.

Department managers told us that the Department reorganization in 1993 resulted in a change in job duties for a significant number of EMSC staff. As a result, EMSC staff efforts did not qualify as allowable activities in a number of Federal programs that usually supported EMSC personal service costs. Much of the staff effort did qualify as allowable activities under other Federal programs but total EMSC staff effort was greater than the Federal funds available in those programs. State funds had to be used to cover this shortfall.

This $2.8 million deficit has been carried forward within TEAS by journal vouchering the amount between Federal and State funds. As the TEAS year covers two State fiscal years, the $2.8 million deficit can be rolled forward into the next TEAS year. This allows the prior year State appropriations to be in balance as of the State fiscal year end and the TEAS expenditures and revenues to be reconciled as of the end of June. (Note: We address weaknesses in the controls over the journal vouchering process in the following subsection.)

Department managers planned to begin reducing this deficit in State fiscal year 1995-96. However, significant budget reductions implemented that year precluded management from taking planned corrective action. Department managers now plan on attempting to eliminate $1.4 million of this deficit in State fiscal year 1996-97 and the remaining $1.4 million in 1997-98. This will be accomplished by expending more effort on Federal programs than funds budgeted for the fiscal year. This excess effort will then be applied to unused prior year Federal funding which has been carried forward.

We question whether this is the most appropriate way to reduce the Department's deficit. This approach indicates that available Federal funding is the deciding factor in assigning staff rather than an objective assessment of the work that management needs accomplished. We also note that the Department use of Federal funds for employing administrative staff is already one of the highest of all the states.

In responding to our draft report, Department officials affirmed their commitment to eliminate the TEAS-related deficit of $2.8 million by March 31, 1998. Officials also stated that procedures are in place to prevent any further imbalances and that future deficits of any kind will be addressed immediately.

## Controls Over Journal Vouchers

The State accounting system allows agencies to use journal vouchers to correct and adjust accounting records. While journal vouchers have many legitimate purposes, they can also be used to misrepresent an agency's or program's true financial status. This occurs when management inappropriately transfers expenses of one program to other programs. Such inappropriate journal transfers result in misleading financial reports. For example, the EMSC deficit was rolled forward from year to year by processing journal vouchers. Therefore, it is imperative that management properly control these transactions to ensure accurate financial reporting. During fiscal year 1995-96, the Department's Bureau of Fiscal Management processed more than 1,700 journal vouchers. Each voucher can include as many as 14 transactions.

We found that controls over the use of journal vouchers were not adequate. As a result, management did not have adequate assurance that the financial information they received represented the Department's actual financial position. For example, we found that there are 39 Department staff who can authorize journal vouchers for processing. About half of these individuals were clerical staff, and there were no limitations on the size of the transactions that any staff person can approve. In addition, there were no reports to management summarizing the number of journal vouchers processed in a particular period or the impact of those transactions on the accounts affected.

We also found that Department staff often could not provide adequate documentation to support journal vouchers processed. In several cases, staff prepared journal vouchers by using data taken directly from computer terminals (screens) linked to the State accounting system. Staff did not document this data or its source. For example, journal voucher number 921 was processed on March 28, 1996 and transferred more than $842,000 of expenses from the Federal Title VI program to various State accounts. There was no documentation on file to support this transaction.

In addition, we noted that Department procedures require the Deputy Commissioners to formally request the transfer of payroll charges, resulting from TEAS adjustments, from one funding source to another. The Deputy Commissioners must provide, among other information, employee specific data, the amount of the funding charges to be transferred, and the justification for any transfer. However, the Department did not document the required data for the journal vouchers we reviewed. Department managers advised us that such documentation is not usually prepared because of the extensive number and complexity of the journal vouchers the Department routinely prepares.

Finally, we found several cases in which the person signing the journal voucher could not explain why the transaction was processed. For instance, journal voucher #926 was processed on March 28, 1996. This journal voucher transferred $5 million of expenses from the VESID Section 110 Federal program to the VESID Case Services State account. Despite the size of this transaction, the person approving it could not explain why it was processed. We were told that a staff person from the Budget Coordination unit prepared the journal voucher and instructed that it be approved. However, Budget Coordination staff were not able to identify the person who initiated this transaction. According to Department procedures, Budget Coordination staff are not authorized to sign journal vouchers. Ultimately, we were able to determine that this transaction was appropriate. However, this example illustrates the lack of controls over the process and the impact that a single journal transaction could have on the Department's financial records.

In responding to our draft report, Department officials stated that all journal vouchers must now be approved by the Chief Financial Officer or the Budget Coordination Bureau Chief, after being authorized by the appropriate Deputy Commissioner's designee. Officials also stated that only journal vouchers with appropriate supporting documentation will be authorized and that journal voucher summary reports will be prepared quarterly.

## Unpaid Obligations (Accounts Payable)

To completely assess the Department's financial position, managers must consider total available funds, expenditures and outstanding obligations. However, the Department's analysis of its deficit did not include obligations incurred in fiscal year 1995-96 but not yet paid. As reported in a prior section of this report, we believe these obligations amount to about $516,000.

A reason why these obligations have not been considered is that Department managers do not have a system for identifying these obligations. Outstanding obligations are not recorded in any one place and are not the responsibility of a specific staff person. Rather, several staff in the Department's Bureau of Fiscal Management maintain files of unpaid vouchers. This information is not summarized or included in financial reports to Department managers.

In addition, the Department's Purchasing unit maintains files of purchase orders that have not been paid. We analyzed these files and found additional unpaid obligations that were not known to Fiscal Management. The information maintained by the purchasing unit was not accurate, readily available, or reported to Fiscal Management. Without information on unpaid obligations, Department managers cannot adequately assess financial position. Department managers told us that they plan to modify their financial management systems to include consideration of unpaid obligations.

In responding to our draft report, Department officials stated that their new automated fiscal monitoring system will include any financial obligation from the time that a purchase order is authorized.

## Recommendations

4. Ensure that established procedures for changing individual employee time allocations are followed. Modifications to time allocations should be made as they occur and not be made after the fact.

5. Stop the practice of covering TEAS imbalances by rolling them forward to subsequent fiscal years.

6. Develop procedures to ensure that all outstanding obligations are accounted for at all times.

7. Improve controls over the processing of journal vouchers by requiring that they be authorized at appropriate levels and requiring that large dollar value transactions be approved by Department management.

8. Prepare periodic reports for Department management that summarize the number, value and the fiscal impact that journal vouchers have on specific programs.

9. Ensure that appropriate documentation is maintained to support the journal vouchers that are processed.

10. Ensure that those authorizing journal vouchers do not approve these transactions unless sufficient justification and explanations are provided.

11. Include information concerning unpaid obligations in financial reports prepared for management.

# Technology Enhancements

The effective use of up-to-date computer technology can give senior managers access to timely, complete and accurate information for the management of operations. A fully automated and user friendly Fiscal Management System (FMS) that captures all financial data on-line at the source provides managers on-line access to budget and expenditure data as well as timely periodic reports on financial status.

The Department has not maximized its technological capabilities to electronically provide the administration and program offices with the fiscal management data they need to properly monitor program funds and account balances. Although the FMS can capture revenue, budget and expenditure data at the cost center level, the available information is difficult to access, is incomplete, untimely and is not coded in the most useful manner. This condition likely contributed to the Department's inability to adequately monitor its financial status—which in turn led to the current deficit.

The FMS, which resides on a Unisys mainframe, cannot produce a complete monthly status report of revenue and expenditures. Although the FMS captures expenditure data from the State accounting system, the FMS has no feature to track outstanding financial obligations. In addition, the FMS is not used to process and keep track of journal vouchers, to automate the TEAS reconciliation, or to calculate the actual and projected revenue for the Cost Recovery account.

The Department has been aware of the inadequacies of the FMS since 1987, when a Task Force on fiscal reporting prepared a list of objectives and goals for the development of a new FMS. In 1992, an internal audit report recommended that the FMS be enhanced or replaced by a new system. Then, in 1993, a work plan was developed to enhance the FMS with the capability to input fiscal expenditure transactions on-line to the mainframe and electronically transfer data between the Department's FMS and the State accounting system. Nonetheless, the Department had made limited progress toward improving its FMS through most of 1995.

After the arrival of Commissioner Mills in 1995, the Department began to make more efforts to improve its budget monitoring and reporting systems. In March 1996, the Department's new Information Technology Improvement Team reported that management needed to make better use of technology for fiscal reporting. A major goal of the Department's new chief information officer includes the multi-phase development of a new fiscal tracking, processing and budgeting system by July 1997. The new system will include the on-line inputting of fiscal transactions.

The system will also include a budget preparation process that allows program managers to identify resources by funding source and relate the budget to the Department's Strategic Plan. It will allow data entry of expenditure plans at the program level, and plans will be linked to actual expenditures. Management is considering scanner inputting to reduce initial data entry efforts. This system will also include data analysis capability, a new data management system, data warehousing, a data collection process, a user's guide and training. Using Oracle, a user friendly data base management system, program officials will have access to all data on the FMS and be able to produce reports needed to monitor their programs. Further, officials said that they acquired Oracle because it would enable staff to use new software, such as data mining.

We believe the initiatives of the Department's new executive team will provide management and the Board of Regents with reliable and timely budget, revenue and expenditure data when it is fully implemented. However, we identified several significant applications, which impact the Department's ability to develop timely and reliable fiscal data, that need to be more fully automated, as follows.

## Time and Effort Allocation System

The State payroll system does not allow more than three funding sources to be designated for individual employee line items. For example, although certain employees work on more than three programs, the payroll system is not designed to allocate actual payroll costs for such employees. As a result, management must calculate the proportion of staff time that can be paid from each funding source and assign a corresponding number of employees to those programs. Staff must then perform quarterly manual reconciliations to adjust the State accounting records to properly reflect actual personal service costs for each program. Adjustments made in this reconciliation also require additional adjustments to fringe benefit and indirect cost rates charged to funding sources.

The current process for allocating the costs associated with employee effort to the appropriate funding source is time consuming, difficult to track, and does not provide timely information to Department and program managers. It can take up to three months to process this reconciliation and have the results reflected in the Department's FMS. During this time, program managers do not have up to date information concerning the fiscal status of their programs.

Better automation could improve the current system and simplify the management and tracking of employee effort and payroll cost distribution. First, all employees with multiple funding sources should be included on the payroll system in State funded positions. At the end of each pay period, employees should be required to enter time and attendance data directly on

the system. Program managers should then review and approve the entries. The system should then allocate employee costs to the appropriate funding sources and produce the necessary journal vouchers to complete the transaction. In addition, this system could calculate appropriate fringe benefit and indirect cost charges and immediately reflect them in the appropriate program accounts. The data from the State payroll system is needed to calculate an accurate transfer of funding effort. The Department should work with the Office of the State Comptroller to determine the best way to ensure that payroll data is available to process the journal vouchers in the most timely manner, and thereby minimize the impact on the Department's State funding allocations.

Department officials have considered these system improvements, but have not included them in their current plans to enhance their financial systems. Management agrees that such system improvements would greatly enhance fiscal management and provide a clearer picture of the Department's fiscal standing. We believe the system would also decrease the amount of manual processing involved in performing the current reconciliation and could potentially reduce the number of journal vouchers that are needed for this reconciliation.

In responding to our draft report, Department officials stated that they have modified the manual time allocation procedures to indicate the proper sources of funding. Officials further stated that full automation of this process is a high priority, to be accomplished when the resources become available.

## Cost Recovery Account

Department managers need accurate and timely Cost Recovery account information to monitor financial condition. At least $8 million of the Department's $11.46 million projected deficit at the end of fiscal year 1995-96 was attributable to the Cost Recovery account. The current process of estimating and collecting revenues for 102 separate accounts is very time consuming. As a result, Cost Recovery account information is not provided timely to management. In addition, the current system has resulted in revenue projections that do not accurately reflect actual collections.

We believe that automating the revenue projection and collection process would result in more accurate and timely information. This information is extremely important to management for monitoring the financial condition of the Cost Recovery account and ultimately the Department.

An automated system could download bi-weekly payroll information from the State payroll system for each Federal and Special Revenue program. Necessary data relating to the payroll costs of these programs could then be extracted from the payroll data base and overhead percentages applied. The

system could also generate necessary journal vouchers to transfer funds from Federal and Special Revenue programs to the Cost Recovery account.

As of June 15, 1996, the Department had no formal plans to automate the revenue collection process as part of the planned enhancements to the FMS, although senior managers advised us that they had intended to develop such plans. Nonetheless, we believe that automating this process would result in the following improvements:

- Cost Recovery account revenues would be calculated and collected bi-weekly rather than quarterly. The Federal funding made available with bi-weekly (rather than quarterly) drawdowns could earn the State's General Fund about $100,000 in additional interest earnings annually.

- Improving the timeliness of revenue collections would give management the ability to better analyze the financial status of the Cost Recovery account. Revenue shortfalls, potential deficits and other problems could be identified and dealt with more timely.

- More accurate data would be available to staff when preparing revenue projections for subsequent budgets. Currently, staff estimate revenue collections for this account by applying overhead rates to payroll charges for one pay period and projecting that amount over the course of a year. Our analysis showed that the 1995-96 revenue projection understated collections. Data from an automated system may be used by staff to more accurately project Cost Recovery account revenues.

- Staff time for collecting Cost Recovery account revenues will be reduced. If this process was automated, staff would not have to manually enter cost data for 83 Federal and 19 Special Revenue programs as is currently done. In addition, staff would not have to manually prepare journal vouchers to collect revenues from each of these programs.

In responding to our draft report, Department officials indicated that actions have been undertaken to automate processes to project and record revenues for the Cost Recovery account. According to officials, such actions will be completed by October 31, 1996.

## Employee Separation Costs

In both 1995 and 1996, Department management had to reduce staffing through layoffs, retirements and transfers. Management has reported that this process may be repeated once more in fiscal year 1996-97. When this occurs, employees leaving the payroll must be paid for accumulated vacation time and

"lagged" salaries. These payments are often thousands of dollars per employee.

Since funds have not been budgeted specifically for separation costs, the Department must absorb such costs from its general operating budget. Therefore, it is imperative that management track such costs and adjust its spending plan to account for unbudgeted costs. More than $2 million of the Department's deficit resulted from unbudgeted employee separation costs.

Department staff currently use a manual process to track these costs. Employees have retired or been laid-off over a period of several months. As such, staff have had to search through a number of bi-weekly payroll registers to identify the employees that left the Department and manually note the amount of the corresponding separation payments. Our review for the 1995-96 year showed that $109,000 of separation costs were omitted from the Department's calculations.

Department officials told us that they are developing plans to automate this process. We believe that this process should be automated so that separation costs can be extracted from the payroll system and accumulated in a timely and efficient manner. Such a system would reduce staff time needed to accumulate this data. It would provide more accurate and timely data to management so that timely adjustments could be made to spending plans.

In responding to our draft report, Department officials stated that the process for calculating separation costs has been improved. Officials added that full automation of this process will be accomplished in conjunction with the automation of the Department's personnel system.

## Recommendations

12. Revise the current system for allocating costs associated with employee effort to the appropriate funding sources.

13. Ensure that revised procedures take advantage of available automation so that the process is streamlined.

14. Automate the revenue calculation and collection process for the Cost Recovery account.

15. Automate the process for identifying and accumulating employee separation costs.

State Education Department
Audited Calculation of Operations Deficit
As of March 31, 1996

| | | |
|---|---|---|
| Department Identified Cumulative Deficit as of March 31, 1996 (From Exhibit B) | | $11,455,000 |
| Less Deficit Reduction Items: | | |
| Cost Recovery Account Deficit Reduction Activities | $6,165,000 | |
| Separation Cost Relief (DOB) | 1,325,000 | |
| Federal Higher Education and Cultural Education Reimbursement | 780,000 | |
| Other Deficit Reduction Initiatives | 113,000 | |
| **Total Deficit Reduction Items** | | 8,383,000 |
| Deficit Carry Over | | 3,072,000 |
| Add Items Identified Per Audit: | | |
| Unpaid OTPS Obligations from FY 1995-96 | $516,000 | |
| Separation Costs Correction | 109,000 | |
| **Total Items Identified Per Audit** | | 625,000 |
| **Net Operations Deficit Per Audit as of March 31, 1996** | | $3,697,000 |

**Exhibit A**

State Education Department
Department Estimated Operations Deficit
As of March 31, 1996

| | | |
|---|---|---|
| Cumulative Deficit Prior To FY 1995-96: | | |
| Unrealized EMSC Federal Reimbursements | $2,800,000 | |
| Cost Recovery Account Opening Deficit On April 1, 1995 | 1,890,000 | |
| HE&P TEAS Deficit | 350,000 | |
| **Subtotal Deficit as of March 31, 1995** | | $5,040,000 |
| Deficit Items FY 1995-96: | | |
| Cost Recovery Account Operating Deficit 4/1/95 - 3/31/96 | $4,075,000 | |
| Unbudgeted Separation Costs | 1,910,000 | |
| HE&P Federal Reimbursement Deficit | 180,000 | |
| Cultural Education Federal Reimbursement Deficit | 250,000 | |
| **Subtotal Deficit Items FY 1995-96** | | 6,415,000 |
| **Department Identified Cumulative Deficit as of March 31, 1996** | | 11,455,000 |
| **Less: Cost Recovery Account Deficit Reduction Activities (as of March 22, 1996)** | | 6,165,000 |
| **Department Projected March 31, 1996 Deficit** | | $5,290,000 |

**Exhibit B**

# Major Contributors to This Report

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NEW YORK
THE STATE OF LEARNING

THE STATE EDUCATION DEPARTMENT / THE UNIVERSITY OF THE STATE OF NEW YORK / ALBANY, N.Y 12234

PRESIDENT OF THE UNIVERSITY
AND COMMISSIONER OF EDUCATION
THE NEW YORK STATE EDUCATION DEPARTMENT
ALBANY, NEW YORK 12234

September 6, 1996

Mr. David Hancox
Director of State Audits
Office of the State Comptroller
A.E. Smith Office Building
Albany, NY 12236

Dear Mr. Hancox:

The following is The State Education Department's response to Draft Audit Report 96-S-31.

**Executive Summary:** The "Audit Observations and Conclusions" make note of the fact that the Department's deficit was $3.7m rather than the $5.3 that was projected. Not included in this section, however, is that the reason for this difference is that the Department received $1.91m in assistance from the Governor and the Director of the Budget that was not included in the original deficit calculations. The report does make note of this action later on page 5.

**Financial Status of the Department:** The report supports our staff's estimates of the Department's financial condition through March 31, 1996 with the addition of updated information on accounts payable.

**Fiscal Management Concerns Recommendations:**

- *Continuously monitor financial condition and address deficits as they occur:* We now have a fiscal monitoring and reporting system that the Chief Financial Officer and Budget Coordination staff utilize to continuously monitor the Department's financial condition, and any projected budget shortfalls are addressed immediately.

- *Continue to update management reporting systems to ensure that relevant financial data is provided to managers timely:* Managers and the Board of Regents are now being given a monthly revenue and expenditure report. We intend to further automate this process and link it to our personnel and fiscal management systems as soon as budget constraints allow.

- *Ensure that major accounts, such as the Cost Recovery Account, are properly automated so that managers can monitor activity on an ongoing basis:* The cost recovery report and all other revenue accounts are include in the monthly fiscal report. These accounts will be included in our future automation efforts.

**Fiscal System Processes Recommendations:**

- *Ensure that established procedures for changing individual employee time allocations are followed. Modifications to time allocations should be made as they occur and not be made after the fact:* The manual time allocation system has been changed to comply with established procedures. Full automation of this system is a top priority in the Department's technology plans.

- *Stop the practice of covering TEAS imbalances by rolling them forward to subsequent fiscal years:* The current TEAS imbalance will be eliminated by March 31, 1998 as per the Department's deficit elimination plan. Procedures are in place to prevent any further imbalances; any future deficits of any kind will be addressed immediately.

- *Develop procedures to ensure that all outstanding obligations are accounted for at all times:* The current fiscal report and future technology improvements will ensure proper accounting.

- *Improve controls over the processing of journal vouchers by requiring that they be authorized at appropriate levels and requiring that large dollar value transactions be approved by Department management:* All journal vouchers must be approved by the Chief Financial Officer or the Budget Coordination Bureau Chief after being authorized by the appropriate deputy's designee.

- *Prepare periodic reports for Department management that summarize the number, value and the fiscal impact that journal vouchers have on specific programs*: Reports are being prepared on a quarterly basis.

- *Ensure that appropriate documentation is maintained to support the journal vouchers that are processed:* Only journal vouchers with the appropriate documentation are being authorized.

- *Ensure that those authorizing journal vouchers do not approve these transactions unless sufficient justification and explanations are provided:* As noted above, no journal vouchers will be approved without the appropriate justification.

- *Include information concerning unpaid obligations in financial reports prepared for management:* The current fiscal report includes all of the obligations on the Comptroller's system. The new automated system will include any obligations from the time that a purchase order is authorized.

**Technology Enhancements recommendations:**

- *Revise the current system for allocating costs associated with employee effort to the appropriate funding sources:* The manual time allocation system has been modified to reflect the proper funding sources. Full automation of this system will further improve it.

- *Ensure that revised procedures take advantage of available automation* so *that the process is streamlined:* The system will be automated as soon as resources are available as this is a high priority.

- *Automate the revenue calculation process for the cost recovery account:* Automation of the Cost Recovery Account revenues will be completed by October 31, 1997.

- *Automate the process for identifying and accumulating employee separation costs:* The process of calculating these costs has been improved. Full automation of this process will be accomplished in conjunction with the automation of the Department's personnel system.

I want to take this opportunity to thank you and your staff for your assistance with our efforts to improve the Department's fiscal systems.

Sincerely,

Richard P. Mills

cc: Patricia Woodworth